

**TENNESSEE DEPARTMENT OF REVENUE
LETTER RULING # 97-28**

WARNING

Letter rulings are binding on the Department only with respect to the individual taxpayer being addressed in the ruling. This presentation of the ruling in a redacted form is informational only. Rulings are made in response to particular facts presented and are not intended necessarily as statements of Department policy.

SUBJECT

How Company X and Company Y should compute their industrial machinery excise tax credits and carryovers thereof when Company X transfers assets to Company Y in exchange for Company Y's stock.

SCOPE

This letter ruling is an interpretation and application of the tax law as it relates to a specific set of existing facts furnished to the Department by the taxpayer. The rulings herein are binding upon the Department, and are applicable only to the individual taxpayer being addressed.

This letter ruling may be revoked or modified by the Commissioner at any time. Such revocation or modification shall be effective retroactively unless the following conditions are met, in which case the revocation shall be prospective only:

- (A) The taxpayer must not have misstated or omitted material facts involved in the transaction;
- (B) Facts that develop later must not be materially different from the facts upon which the ruling was based;
- (C) The applicable law must not have been changed or amended;
- (D) The ruling must have been issued originally with respect to a prospective or proposed transaction; and
- (E) The taxpayer directly involved must have acted in good faith in relying upon the ruling and a retroactive revocation of the ruling must inure to his detriment.

FACTS

Company X is a Tennessee corporation incorporated in [YEAR] and engaged in the [TYPE BUSINESS]. For federal tax purposes, it elected S corporation status in [YEAR] and files its tax returns on a calendar year basis.

Prior to the transaction to be described below, Company X had two divisions, both at the same location in Tennessee. One division conducted [OPERATION 1] and the other division was a [OPERATION 2]. Company X had [NUMBER] shares of voting common stock outstanding. [MR. A] and his brother, [MR. B], together with members of their respective families, each owned [EQUAL NUMBER] shares of the stock. Company X had gross receipts and operating expenses representative of the active conduct of a [TYPE BUSINESS] trade or business for each of the past five years.

Serious disagreements, resulting adversely on day-to-day operations of Company X, arose between the [FAMILY NAME] brothers with regard to the management and operation of Company X's business. These disputes concerned [ISSUES OF DISAGREEMENT].

In order to eliminate the problems generated by these disputes, the [OPERATION 1] division and the [OPERATION 2] business were divided into two separate corporations. Pursuant to this, Company X formed a Tennessee corporation (Company Y) with [NUMBER] shares of no par value common stock. On [TRANSFER DATE] Company X transferred approximately one-half of its assets representing the [OPERATION 2] business to Company Y in exchange for all of Company Y's stock and the assumption by Company Y of related liabilities. Company X retained the [OPERATION 1] division and its related assets and liabilities. [MR. B] and members of his family then exchanged, on a pro rata basis, all of their shares of Company X's stock for the [NUMBER] shares of Company Y's stock held by Company X and Company Y elected to be taxed as an S Corporation by the Internal Revenue Service.

The Internal Revenue Service has advised the Company X that the above described transaction will be treated as a reorganization under Section 368(a)(1)(D) of the Internal Revenue Code.

QUESTION PRESENTED

Under T.C.A. § 67-4-808(4), what industrial machinery excise tax credits and carryovers thereof are Company X and Company Y entitled to take and how are such credits to be computed?

RULINGS

Subject to the provisions of T.C.A. § 67-4-808(4), Company X is entitled to take industrial machinery excise tax credits and carryovers thereof for 1% of the purchase price of industrial machinery it purchases on or after [TRANSFER DATE]. Also, subject to the provisions of T.C.A. § 67-4-808(4), Company X is entitled to the applicable credit and carryover thereof on industrial machinery it purchased before [TRANSFER DATE] and did not transfer to Company Y and on which recapture is not required by T.C.A. § 67-4-808(4)(D). Company X must recapture any portion of the industrial machinery excise tax credit taken on machinery transferred to Company Y before the expiration of its useful life according to depreciation guidelines in effect for excise tax purposes.

In accordance with T.C.A. § 67-4-804(4), Company Y is entitled to a 1% industrial machinery excise tax credit and carryover thereof on the purchase price of the industrial machinery it purchases on or after [TRANSFER DATE] and a credit of 1% of the purchase price of industrial machinery transferred to it by the Taxpayer on [TRANSFER DATE]. The purchase price of the industrial machinery transferred is the fair market value of such machinery at the time of its transfer.

In no case shall the industrial machinery excise tax credit taken exceed 50% of the excise tax liability shown on the return before the credit is taken.

ANALYSIS

An industrial machinery excise tax credit is provided by T.C.A. § 67-4-808(4) set forth below:

(4) (A) On each excise tax return, a credit shall be allowed for a percentage of the purchase price of industrial machinery purchased during the tax period covered by the return and located in Tennessee. For purposes of this section, "industrial machinery" means:

(i) "Industrial machinery" as defined by § 67-6-102; or

(ii) "Computer," "computer network," "computer software," or "computer system" as defined by § 39-14-601 and any peripheral devices, including, but not limited to, hardware such as printers, plotters, external disc drives, modems, and telephone units purchased in the process of making the "required capital investment" in Tennessee described in § 67-4-908 to qualify for the job tax credit.

(B) The credit taken on any return, however, shall not exceed fifty percent (50%) of the excise tax liability shown by any such return before the credit is taken;

(C) Any unused credit incurred for fiscal years ending on or after March 15, 1982, may be carried forward in any tax period for fifteen (15) years or until such credit is taken;

(D) If any such industrial machinery, for the purchase of which a tax credit has been allowed, is sold or removed from this state during its useful life according to the depreciation guidelines in effect for excise tax purposes, the department shall be entitled to recapture a portion of the credit allowed by increasing the excise tax liability of any taxpayer, for the taxable period during which such machinery was sold or removed, in an amount equal to the percentage of useful life remaining on such industrial machinery at the time of sale or removal times the total credit taken on the purchase of such machinery;

(E) The credit provided in subdivision (4) shall be computed as follows:

(i) Machinery purchased from July 1, 1980, through June 30, 1981 - .2% of the purchase price;

(ii) Machinery purchased from July 1, 1981, through June 30, 1982 - .4% of the purchase price;

- (iii) Machinery purchased from July 1, 1982, through June 30, 1983 - .6% of the purchase price;
 - (iv) Machinery purchased from July 1, 1983, through June 30, 1984 - .8% of the purchase price; and
 - (v) Machinery purchased on or after July 1, 1984 - 1% of the purchase price;
- (F) For purposes of the allowance of the credit against excise taxes under this section, any taxpayer who is a lessee of new industrial machinery and the original user thereof (including a lessee from an industrial development corporation as defined by title 7, chapter 53, or other tax exempt entity) shall be treated as having purchased such machinery during the tax period in which it is placed in service by the lessee, at an amount equal to its purchase price; and
- (G) If industrial machinery is leased for a period which constitutes less than eighty percent (80%) of its useful life, then the lessee shall be deemed to have purchased only a portion of such machinery, at an amount determined by multiplying the actual purchase price of the machinery by a fraction, the numerator of which is the lease term, and the denominator the useful life of the leased machinery;

T.C.A. § 56-4-808(4)(A) grants the industrial machinery excise tax credit to the machinery purchaser based on the “purchase price” of the machinery.

All industrial machinery purchased prior to [TRANSFER DATE] was purchased by Company X. Therefore, on its franchise, excise tax returns filed for tax years ended prior to [TRANSFER DATE], subject to the provisions of T.C.A. § 67-4-808(4), Company X was entitled to take the applicable credit, or any carryover thereof, based on the purchase price of industrial machinery defined in T.C.A. § 67-6-102(12) or T.C.A. § 67-4-808(4)(A)(ii). For tax years beginning on or after [TRANSFER DATE], subject to the provisions of T.C.A. § 67-4-808(4), Company X may take the credit on any industrial machinery it purchases on or after [TRANSFER DATE] and also may take any industrial machinery excise tax credit carryovers pertaining to the industrial machinery purchased prior to [TRANSFER DATE] which it did not transfer to Company Y and on which T.C.A. § 67-4-808(4)(D) does not require recapture. T.C.A. § 67-4-808(4)(B) limits the amount of industrial machinery excise tax credit that may be taken in any tax year to 50% of the excise tax liability before the credit is taken.

For tax years beginning on or after [TRANSFER DATE], subject to the provisions of T.C.A. § 67-4-808(4), Company Y would be entitled to take the credit, or carryover thereof, on any industrial machinery it purchases on or after [TRANSFER DATE].

With regard to the industrial machinery assets transferred by Company X to Company Y on [TRANSFER DATE], the matter turns on whether there was a “sale” of the assets in question and consequently a “purchase price” on which to base the credit.

To a large extent, the Tennessee industrial machinery excise tax credit has its genesis in T.C.A. § 67-6-102, a sales tax statute specifically referenced in T.C.A. § 67-4-808(4)(A)(i). It is to the Tennessee sales tax law that we must look to determine whether

the industrial machinery transferred by Company X to Company Y was sold for purposes of the credit.

T.C.A. § 67-6-102(2)(A) defines a “sale” as follows:

“Sale” means any transfer of title or possession, or both, exchange, barter, lease or rental conditional, or otherwise, in any manner or by any means whatsoever of tangible personal property for a consideration . . .

In the described transaction, the title and possession of industrial machinery has been transferred from Company X to Company Y, a new corporation. The consideration for the transfer is the increase in the value of Company Y’s stock held by Company X prior to its distribution to [MR. B] and members of his family in exchange for the stock of Company X that they held. This increase in value is the “purchase price” of the machinery transferred. The purchase price of the industrial machinery transferred would be measured by the fair market value of the industrial machinery assets at the time of their transfer. (*See: D. Canale and Co. v. Celauro*, 765 S.W.2d 736 (Tenn. 1989))

Company X has sold the industrial machinery assets it transferred to Company Y and Company Y is the purchaser of such assets.

T.C.A § 67-4-808(4)(D) requires Company X to recapture any portion of the industrial machinery excise tax credit taken on industrial machinery transferred to Company Y on [TRANSFER DATE] if such assets were transferred during their useful life according to the depreciation guidelines in effect for excise tax purposes. Accordingly, Company X must increase its [TAX YEAR OF THE TRANSFER] excise tax liability in an amount equal to the percentage of useful life remaining on such industrial machinery at the time of the transfer times the total credit taken on the purchase of such machinery.

For the tax year [TAX YEAR OF THE TRANSFER], subject to the provisions of T.C.A. § 67-4-808(4), Company Y, as the purchaser of the industrial machinery transferred to it by the Company X on [TRANSFER DATE], is entitled to take an industrial machinery excise tax credit of 1% of the purchase price of the qualifying industrial machinery assets transferred provided such credit does not exceed fifty percent (50%) of the excise tax liability shown on the return before the credit is taken. The purchase price of the industrial machinery in question will be determined as described above and any unused credit from such purchase of industrial machinery will be subject to carryover under the provisions of T.C.A. § 67-4-808(4)(C).

Arnold B. Clapp, Senior Tax Counsel

APPROVED:

Ruth E. Johnson, Commissioner

DATE:

7-3-97